FINANCIAL AUDIT
OF THE

MICHIGAN LIQUOR CONTROL COMMISSION

DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

October 1, 1996 through September 30, 1997

63-161-98

EXECUTIVE DIGEST

MICHIGAN LIQUOR CONTROL COMMISSION

INTRODUCTION

This report contains the results of our financial audit* of the Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services (CIS), for the period October 1, 1996 through September 30, 1997.

AUDIT PURPOSE

This financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

MLCC is governed by Sections 436.1 - 436.58 of the *Michigan Compiled Laws* (Act 8, P.A. 1933, the Michigan Liquor Control Act). MLCC consists of five members appointed by the Governor with the advice and consent of the Senate, each for a term of four years. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Act. MLCC is organizationally located within CIS.

During fiscal year 1996-97, MLCC privatized the liquor inventory warehousing and distribution function, which

** See glossary on page 44 for definition.*

required extensive revision to the process in which liquor products were ordered, purchased, stored, and delivered to the retailers.

On October 1, 1996, prior to privatization, MLCC had 532 employees. As of September 30, 1997, after privatization, MLCC had 152 employees. During fiscal year 1996-97, MLCC issued 31,593 retail liquor licenses and 1,990 manufacturer/wholesaler licenses. The Liquor Purchase Revolving Fund's total revenue for the fiscal year was approximately $114.6 million and total expenses and operating transfers were approximately $25.4 million.

AUDIT OBJECTIVES AND CONCLUSIONS

Audit Objective: To assess the adequacy of MLCC's internal control structure*.

Conclusion: Our assessment of MLCC's internal control structure disclosed two material weaknesses* :

- MLCC's internal control structure did not adequately separate duties related to the administration and distribution of the State's liquor inventory (Finding 1).

  MLCC responded that it agrees that proper and sound internal controls are necessary. Beginning in October 1997, MLCC established numerous business operating procedures to improve and strengthen internal controls. Among the many procedures is one where, on a regular basis, MLCC reviews a sample of signed licensee invoices compared to sales as reported by authorized distribution agents. This procedure is designed to help ensure that all orders have been reported to MLCC. MLCC has been

* *See glossary on page 44 for definition.*

working with the Department of Treasury since before the audit began to implement an electronic transfer of funds program for liquor sales proceeds.

- MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. As a result of the errors noted, we expressed a qualified opinion on MLCC's statement of cash flows. (Finding 2)

  MLCC responded that it agrees that there should be consistency between the *SOMCAFR* and its statements. It is important to point out that the bottom line of the statement of cash flows (cash and cash equivalents), as reported by MLCC, was correct and consistent with the *SOMCAFR*. There was no loss of funds involved in this presentation of the statement of cash flows. The difference between the statements is one of presentation. MLCC has now established a procedure to meet with Department of Management and Budget (DMB) staff each year to jointly review the statement of cash flows to ensure consistent presentation.

We also noted reportable conditions* related to the reconciliation of liquor sales, liquor inventory controls, and the distribution of tax revenue (Findings 3 through 5).

Audit Objective: To assess MLCC's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and CIS policies and procedures.

** See glossary on page 44 for definition.*

Conclusion: Our assessment of MLCC's compliance with laws and regulations disclosed an instance of noncompliance that had a material effect on MLCC's financial statements. As reported in Finding 2 under our internal control objective, MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *SOMCAFR*. As a result of MLCC's material noncompliance with Act 431, P.A. 1984, as amended (Sections 18.1101 - 18.1594 of the *Michigan Compiled Laws*), we expressed a qualified opinion on MLCC's statement of cash flows.

Audit Objective: To audit the financial statements of the Liquor Purchase Revolving Fund as of and for the fiscal year ended September 30, 1997.

Conclusion: We expressed an unqualified opinion on MLCC's balance sheet and statement of revenues, expenses, and changes in retained earnings and a qualified opinion on its statement of cash flows. As reported in Finding 2 under our internal control objective, our audit disclosed a material weakness in that MLCC's internal control structure did not ensure the accurate preparation and presentation of its statement of cash flows.

Audit Objective: To assess MLCC's effectiveness in closing the State liquor stores and warehouses and disposing of related equipment inventory.

Conclusion: We concluded that MLCC was generally effective in closing the State liquor stores and warehouses and disposing of related equipment inventory. However, as reported in Finding 4 under our internal control objective, we noted a reportable condition related to a liquor inventory shortage disclosed during the closing of the State liquor stores and warehouses.

Audit Objective: To examine the propriety of the Commissioners' expenses.

Conclusion: We concluded that, generally, the expenses incurred by the Commissioners were appropriate and associated with operations of MLCC. However, we noted reportable conditions related to telephone usage and payroll and travel expenses (Findings 6 and 7).

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the Michigan Liquor Control Commission for the period October 1, 1996 through September 30, 1997. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

AGENCY RESPONSES AND PRIOR AUDIT FOLLOW-UP

Our audit report contains 7 findings and 11 corresponding recommendations. MLCC's preliminary response indicated that MLCC either has complied with or will comply with the 11 recommendations.

MLCC had complied with 2 of the 7 prior audit recommendations. Because of the privatization of the liquor distribution system, the remaining 5 prior audit recommendations are no longer applicable.

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Ms. Jacquelyn A. Stewart, Chairperson
Michigan Liquor Control Commission
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Stewart and Ms. Wilbur:

This is our report on the financial audit of the Michigan Liquor Control Commission, Department of Consumer and Industry Services, for the period October 1, 1996 through September 30, 1997.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and independent auditor's reports on the internal control structure, on compliance with laws and regulations, and on the financial statements. This report also contains the Liquor Purchase Revolving Fund financial statements and notes to financial statements; the Michigan Liquor Control Commission's schedule of governmental funds revenue and operating transfers, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Michigan Liquor Control Commission is governed by Sections 436.1 - 436.58 of the *Michigan Compiled Laws* (Act 8, P.A. 1933, the Michigan Liquor Control Act). MLCC consists of five members appointed by the Governor with the advice and consent of the Senate, each for a term of four years. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Act. MLCC is organizationally located within the Department of Consumer and Industry Services.

MLCC has primary responsibility for the Liquor Purchase Revolving Fund, which accounts for the purchase, distribution, and sale of alcoholic liquor. The net income from alcoholic liquor sales is transferred to the General Fund in accordance with Section 18.1435 of the *Michigan Compiled Laws.* MLCC licensing and enforcement activities are accounted for in the State's General Fund.

During fiscal year 1996-97, MLCC privatized the liquor inventory warehousing and distribution function, which required extensive revision to the process in which liquor products were ordered, purchased, stored, and delivered to the retailers. MLCC closed all 63 wholesale State liquor stores and its 3 liquor warehouses. Under the privatization agreement, manufacturers of liquor were required to contract with authorized distribution agents (ADAs) to transport, store, and distribute their products to retail licensees. ADAs are required to receive certification from MLCC to become authorized distribution agents.

On October 1, 1996, prior to privatization, MLCC had 532 employees. As of September 30, 1997, after privatization, MLCC had 152 employees. During fiscal year 1996-97, MLCC issued 31,593 retail liquor licenses and 1,990 manufacturer/wholesaler licenses. The Liquor Purchase Revolving Fund's total revenue for the fiscal year was approximately $114.6 million and total expenses and operating transfers were approximately $25.4 million.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial audit of the Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services (CIS), had the following objectives:

1. To assess the adequacy of MLCC's internal control structure.

2. To assess MLCC's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and CIS policies and procedures.

3. To audit the financial statements of the Liquor Purchase Revolving Fund as of and for the fiscal year ended September 30, 1997.

4. To assess MLCC's effectiveness in closing the State liquor stores and warehouses and disposing of related equipment inventory.

5. To examine the propriety of the Commissioners' expenses.

Audit Scope

Our audit scope was to examine the financial and other records of the Michigan Liquor Control Commission for the period October 1, 1996 through September 30, 1997. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 7 findings and 11 corresponding recommendations. MLCC's preliminary response indicated that MLCC either has complied with or will comply with the 11 recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require CIS to develop a formal response to our findings and recommendations within 60 days after release of the audit report.

MLCC had complied with 2 of the 7 prior audit recommendations. Because of the privatization of the liquor distribution system, the remaining 5 prior audit recommendations are no longer applicable.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the adequacy of the Michigan Liquor Control Commission's (MLCC's) internal control structure.

Conclusion: Our assessment of MLCC's internal control structure disclosed two material weaknesses. MLCC's internal control structure did not adequately separate the duties related to the administration and distribution of the State's liquor inventory. Also, MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*). As a result of the errors noted, we expressed a qualified opinion on MLCC's statement of cash flows. We also noted reportable conditions related to the reconciliation of liquor sales, liquor inventory controls, and the distribution of tax revenue.

FINDING

1. Separation of Duties

MLCC's internal control structure did not adequately separate duties related to the administration and distribution of the State's liquor inventory.

MLCC's liquor distribution internal control structure permits authorized distribution agents (ADAs) to perform multiple functions that are incompatible with maintaining a system of sound internal controls. ADAs maintain physical control of the State's liquor inventory in the ADAs' warehouses, obtain liquor orders from liquor retailers, deliver liquor to liquor retailers, collect and deposit proceeds from liquor sales into designated State bank accounts, adjust liquor sales records for changes between liquor ordered and liquor delivered, and report liquor sales to MLCC. Because ADAs are able to transmit liquor order transactions, maintain physical custody of the State's liquor inventory, and collect and deposit proceeds from liquor sales, the potential exists for the misappropriation of liquor sales proceeds or the State's liquor inventory.

MLCC needs to clearly prescribe its and the ADAs' respective responsibilities. Although MLCC did not have contractual agreements with ADAs, MLCC has the authority to prescribe business practices for ADAs. Section 436.3a of the *Michigan Compiled Laws* states that ADAs are subject to uniform requirements, including business operating procedures, which MLCC may prescribe. Internal control procedures had not been developed to address the separation of duties between MLCC and ADAs and among the ADAs at their operating level.

An effective internal control structure should include separation of duties related to maintaining physical custody of assets and accounting for such assets to reduce the possibility of any one entity from concealing errors or irregularities. MLCC could strengthen its internal control structure with the implementation of control procedures related to the transmitting of liquor purchases and electronic transferring of funds from liquor sales proceeds.

Instituting procedures that require liquor retailers to transmit liquor orders directly through MLCC would help ensure the propriety of liquor orders. In addition, it would enable MLCC to reconcile liquor orders to liquor sales, which would increase the accountability of the State's liquor inventory.

Electronic funds transfers of liquor sales proceeds into State bank accounts eliminates the need for ADAs' to collect funds upon delivery of liquor to retailers. This would help ensure the timeliness and accuracy of deposits, and provides separation of duties related to the custody of the State's assets, and the accounting for such assets. Electronic funds transfers eliminate the need for delivery drivers to possess liquor sales proceeds, making proceeds less susceptible to theft, during deliveries of liquor to retailers.

During January 1997, MLCC started its new privatized liquor distribution system in which liquor was distributed Statewide to approximately 14,000 liquor retailers by 3 primary ADAs. Since the start of the new distribution system, ADAs delivered and collected an estimated $488 million of liquor sales and related taxes through the remainder of the fiscal year.

RECOMMENDATION

We recommend that MLCC establish a sound internal control structure to help ensure the adequate separation of duties related to the administration and distribution of the State's liquor inventory.

AGENCY PRELIMINARY RESPONSE

MLCC agrees that proper and sound internal controls are necessary. MLCC informed us that, beginning in October 1997, it established numerous business operating procedures to improve and strengthen internal controls. Among the many procedures is one in which, on a regular basis, MLCC reviews a sample of signed liquor retailer invoices compared to sales as reported by ADAs. This procedure is designed to help ensure that all orders have been reported to MLCC. MLCC has been working with the Department of Treasury since before the audit began to implement an electronic transfer of funds program for liquor sales proceeds.

FINDING

2. Statement of Cash Flows

MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *SOMCAFR.*

Department of Management and Budget (DMB) Administrative Guide procedure 1210.09 requires that all financial statements issued by State agencies be consistent with the *SOMCAFR.* This procedure helps to ensure the fair presentation of the *SOMCAFR* by requiring agencies to take responsibility for preparing their financial statements on a timely basis.

MLCC's statement of cash flows contained several errors that resulted in the statement being materially misstated. These misstatements did not result in a loss or misappropriation of fund resources. However, because of MLCC's preparation errors, the statement's cash flows from operating activities were approximately $10.4 million more than the amount reported in the *SOMCAFR* and its cash flows from noncapital financing activities were approximately $10.1 million less than the amount reported in the *SOMCAFR*.

Recommendation

We recommend that MLCC implement control procedures to ensure the accurate preparation of its statement of cash flows and the presentation of this financial statement consistent with the *SOMCAFR.*

Agency Preliminary Response

MLCC agrees that there should be consistency between the *SOMCAFR* and its statements. It is important to point out that the bottom line of the statement of cash flows (cash and cash equivalents), as reported by MLCC, was correct and consistent with the *SOMCAFR*. There was no loss of funds involved in this presentation of the statement of cash flows. The difference between the statements is one of presentation. MLCC informed us that it has now established a procedure to meet with DMB staff each year to jointly review the statement of cash flows to ensure consistent presentation.

Finding

3. Reconciliation of Liquor Sales

MLCC control procedures did not ensure the reconciliation of liquor sales revenue with funds deposited. Reconciliations are necessary for proper financial reporting and to help ensure that all funds due are received.

Our review of MLCC revenue reconciliation processes disclosed that MLCC could not reconcile funds deposited into designated State bank accounts with liquor sales revenue reported by the ADAs.

ADAs deliver liquor to retailers and receive payments for the deliveries. Also, ADAs deposit the receipts into designated State bank accounts and submit sales and deposit documentation to MLCC for processing. MLCC procedures require ADAs to report liquor sales and deposits on a daily basis in a format prescribed by MLCC.

MLCC's attempt to reconcile liquor sales documentation with amounts deposited by the ADAs disclosed that total deposits exceeded documented liquor sales by approximately $2.3 million at September 30, 1997. MLCC could not reconcile the difference because ADAs did not submit documentation in a timely manner or in an approved format that disclosed all liquor sales and adjustments. As a result, MLCC did not have assurance that all liquor sales revenue was received and appropriately recorded in the State's accounting system. Liquor sales exceeded $578 million for fiscal year 1996-97.

RECOMMENDATION

We recommend that MLCC establish control procedures to ensure the reconciliation of liquor sales revenue with funds deposited.

AGENCY PRELIMINARY RESPONSE

MLCC agrees with the recommendation and informed us that it has complied. Beginning in October 1997, MLCC established reconciliation procedures for liquor sales on a weekly basis. The procedure includes a reconciliation of all transactions and a dated signature of agreement on reconciliations by each ADA.

FINDING

4. Liquor Inventory Controls

MLCC had not established control procedures to verify liquor inventory stored at ADA locations or to determine the disposition of missing liquor inventory disclosed during the closing of State liquor stores and warehouses.

Our review of agency procedures disclosed:

a. MLCC did not perform a reconciliation of inventory to verify its liquor inventory stored at ADA locations. Liquor inventory purchased by MLCC prior to distribution to liquor retailers is stored at ADA locations.

   DMB Administrative Guide procedures require agencies to reconcile the number of inventory items with the accounting records or, with the approval of the DMB Office of Financial Management, to perform alternative inventory procedures.

   MLCC uses its internal accounting system to maintain a record of the liquor inventory. This system relies on liquor purchase and sales documentation provided by the ADAs. Because ADAs are responsible for both providing accounting documentation and maintaining physical custody of the liquor in the warehouses, it is essential that MLCC develop control procedures to verify the liquor inventory. The liquor inventory was valued at $12.1 million at the end of fiscal year 1996-97.

b. MLCC did not take sufficient action to determine the disposition of missing liquor inventory disclosed during the closing of the State liquor stores and warehouses.

During the period January 23, 1997 through February 28, 1997, MLCC transferred all liquor inventory from its 63 State liquor stores and its Escanaba warehouse to its Lansing and Lincoln Park warehouses as part of the final steps to convert to the privatized liquor distribution system. MLCC accounting records reported liquor inventory of approximately $10 million at the time of the State liquor store and warehouse closings. However, an MLCC physical inventory completed after the transfer to the Lansing and Lincoln Park warehouses disclosed an approximate $650,000 liquor inventory shortage.

MLCC should have completed a physical inventory of the liquor at each location at the time of the closings and reconciled the physical inventory totals with the accounting inventory records.

RECOMMENDATION

We recommend that MLCC improve control procedures over its liquor inventory.

AGENCY PRELIMINARY RESPONSE

MLCC agrees with the recommendation and informed us that it has complied. Beginning in October 1997, MLCC implemented alternative control procedures to verify inventory from the beginning of privatization forward and has obtained approval from DMB for this alternative approach.

FINDING

5. Distribution of Tax Revenue

MLCC's internal control structure did not help ensure the proper distribution of designated liquor tax revenue in accordance with the *Michigan Compiled Laws*.

Sections 436.101 - 436.102, 436.121 - 436.122, and 436.143 - 436.145 of the *Michigan Compiled Laws* require MLCC to collect and distribute a 4% tax on liquor sales to the School Aid Fund, General Fund, and Convention Facility and Development Fund. ADAs collect designated liquor tax revenue during the delivery of liquor to retailers. ADAs deposit liquor sales and designated liquor tax revenue and submit sales documentation to MLCC.

MLCC reported liquor sales revenue of approximately $578 million for fiscal year 1996-97, which should result in designated liquor tax revenue of $69.4 million as required by the *Michigan Compiled Laws*. However, MLCC reported designated liquor tax revenue of $67.4 million, approximately $2.0 million less than required by the *Michigan Compiled Laws.* MLCC stated that all designated liquor tax revenue was collected. The ADAs did not always accurately report the revenue on sales documentation; therefore, MLCC could not distribute the designated liquor tax revenue to the appropriate funds. As a result, liquor sales revenue was overstated by the amount of designated liquor tax revenue that was not distributed.

RECOMMENDATIONS

We recommend that MLCC establish an effective internal control structure to help ensure the proper distribution of designated liquor tax revenue in accordance with the *Michigan Compiled Laws*.

We also recommend that MLCC properly distribute designated liquor tax revenue for fiscal year 1996-97.

AGENCY PRELIMINARY RESPONSE

MLCC agrees with these recommendations and informed us that it has complied. Information is now received from ADAs in a timely manner and reconciled to ensure proper distribution of designated liquor tax revenue. The tax distribution for fiscal year 1996-97 was corrected in March 1998, when information became available. All State of Michigan taxes were collected in total and distributed, as applicable.

COMPLIANCE WITH LAWS AND REGULATIONS

COMMENT

Audit Objective: To assess MLCC's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and Department of Consumer and Industry Services (CIS) policies and procedures.

Conclusion: Our assessment of MLCC's compliance with laws and regulations disclosed an instance of noncompliance that had a material effect on MLCC's financial statements. As reported in Finding 2 under our internal control objective, MLCC's internal control structure did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *SOMCAFR*. As a result of MLCC's material noncompliance with Act 431, P.A. 1984, as amended (Sections 18.1101 - 18.1594 of the *Michigan Compiled Laws*), we expressed a qualified opinion on MLCC's statement of cash flows.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit the financial statements of the Liquor Purchase Revolving Fund as of and for the fiscal year ended September 30, 1997.

Conclusion: We expressed an unqualified opinion on MLCC's balance sheet and statement of revenues, expenses, and changes in retained earnings and a qualified opinion on its statement of cash flows. As reported in Finding 2 under our internal control objective, our audit disclosed a material weakness in that MLCC's internal control structure did not ensure the accurate preparation and presentation of its statement of cash flows.

CLOSING OF STATE LIQUOR STORES AND WAREHOUSES

COMMENT

Audit Objective: To assess MLCC's effectiveness in closing the State liquor stores and warehouses and disposing of related equipment inventory.

Conclusion: We concluded that MLCC was generally effective in closing the State liquor stores and warehouses and disposing of related equipment inventory. However, as reported in Finding 4 under our internal control objective, we noted a reportable condition related to a liquor inventory shortage disclosed during the closing of the State liquor stores and warehouses.

COMMISSIONERS' EXPENSES

COMMENT

Background: MLCC consists of five members appointed by the Governor with the advice and consent of the Senate, each for a term of four years. Expenses incurred by the Commissioners are identified separately in the State's accounting records. As a result of a request from the State of Michigan's Department of Attorney General, we reviewed the Commissioners' expenses for the period October 1, 1994 through September 30, 1997.

Audit Objective: To examine the propriety of the Commissioners' expenses.

Conclusion: We concluded that, generally, the expenses incurred by the Commissioners were appropriate and associated with operations of MLCC. However, we noted reportable conditions related to telephone usage and payroll and travel expenses.

FINDING

6. Telephone Usage

MLCC did not have control procedures to monitor the Commissioners' use of State telephones, including cellular telephones, and State-issued telephone credit cards.

Our review of telephone records disclosed that some Commissioners used their State telephones and State-issued telephone credit cards for personal use.

DMB Administrative Guide procedure 1210.13 prohibits the use of State telephones and State-issued telephone credit cards for personal long distance calls, except as necessary to communicate unavoidable changes in work schedules or as authorized by agency management. Also, the policy requires that any charges for telephone calls made for personal purposes, along with applicable State and federal taxes, must be collected from the individuals who placed the calls. Further, DMB Administrative Guide procedure 1410.15 states that the use of cellular telephones should be limited to essential specific uses. The policy lists emergencies, protection of State assets, safety and welfare of citizens or personnel, and communication with the Governor's office as justification of use of cellular telephones.

CIS reviewed the Commissioners' telephone expenses for the period October 1, 1994 through September 30, 1997. CIS's review focused primarily on calls made outside the normal business hours of 7 a.m. through 6 p.m., Monday through Friday.

Our review of the Commissioners' telephone expenses included all telephone calls for the period October 1, 1994 through September 30, 1997. MLCC could not find an estimated $2,000 of telephone billing records for our review period. Also, after reviewing the remaining telephone billing records supporting the $15,517 in telephone expenses, we could not positively identify if some telephone calls were for MLCC business. We requested that Commissioners identify if these telephone calls were for MLCC business or were personal. The schedule below summarizes the Commissioners' responses:

	Former Commissioners						Current Commissioners			
	Arthurhultz		Perry		Pulliam		Podalsky		Stewart	
	Number of Calls	Amount	Number of Calls	Amount	Number of Calls	Amount	Number of Calls	Amount	Number of Calls	Amount
I. Identified by Commissioners as personal:										
In-State	489	$ 565	0	$	251	$ 224	706	$ 555	12	$ 10
Out-of-State	575	964	0		0		0		0	
International	51	382	0		0		0		0	
	1,115	$ 1,910	0	$ 0	251	$ 224	706	$ 555	12	$ 10
II. Identified by Commissioners as business related:										
In-State	1,200	$ 1,806	3,727	$ 5,037	1,422	$ 1,556	1,056	$ 965	522	$ 560
Out-of-State	86	201	33	89	0		0		0	
International	0		0		0		0		0	
	1,286	$ 2,007	3,760	$ 5,126	1,422	$ 1,556	1,056	$ 965	522	$ 560
III. Not identified by Commissioners:										
In-State	550	$ 741	0	$	632	$ 683	193	$ 207	33	$ 42
Out-of-State	559	856	0		0		0		0	
International	9	75	0		0		0		0	
	1,118	$ 1,672	0	$ 0	632	$ 683	193	$ 207	33	$ 42
Totals	3,519	$ 5,589	3,760	$ 5,126	2,305	$ 2,463	1,955	$ 1,727	567	$ 612
Amounts billed by CIS for personal calls from the CIS review:		$ 2,803		$ 875		$ 50		$ 519		$ 0
Amounts reimbursed for personal calls:		$ 2,803		$ 0		$ 50		$ 519		$ 10

Note: The names of the Commissioners were placed on this table at the request of CIS and MLCC management.

Our review of telephone calls identified by Commissioners as business related (II) disclosed numerous instances in which the telephone calls appeared to be personal. For example, some Commissioners identified telephone calls to insurance agencies, beauty salons, doctors, churches, and music theaters as calls associated with MLCC business operations. Former Commissioner Perry indicated that all calls were for MLCC business; however, our review of the Commissioner's phone records would suggest that many telephone calls did not relate to MLCC business. For example, approximately 300 calls were made to the Commissioner's relatives. Also, over 600 calls were made to four telephone numbers that MLCC could not identify as having business related to the Commission.

In some instances, Commissioners did not identify if telephone calls were for MLCC business or personal (III). However, our review of these telephone calls disclosed telephone calls that appeared personal. For example, former Commissioner Arthurhultz did not identify telephone calls made to a relative, individuals in foreign countries, an out-of-State real estate agent, and art importers. MLCC should develop procedures to monitor telephone usage to ensure that State telephones and telephone credit cards are used in accordance with DMB Administrative Guide procedures.

RECOMMENDATIONS

We recommend that MLCC develop control procedures to monitor the Commissioners' use of State telephones, including cellular telephones, and State-issued telephone credit cards.

We also recommend that MLCC review the telephone calls made by the Commissioners and seek reimbursement for those not related to MLCC business operations.

AGENCY PRELIMINARY RESPONSE

MLCC agrees with these recommendations and informed us that it has complied. Control procedures have been developed to monitor the Commissioners' use of State telephones and State-issued telephone credit cards. CIS has sought reimbursement for telephone calls not related to MLCC business operations.

FINDING

7. Payroll and Travel Expenses

MLCC had not established control procedures to verify the Commissioners' payroll and travel expenses.

Our review of the Commissioners' expenses for the period October 1, 1994 through September 30, 1997 disclosed that the former chairperson sometimes did not document payroll and travel expenses and directed State employees to perform functions not related to MLCC operations:

a. The former chairperson's biweekly time and attendance reports did not agree in 27 instances with other documentation, such as travel expense vouchers, motor vehicle mileage logs, telephone billing statements, and the former chairperson's work itinerary maintained by the former chairperson's secretary. In these instances, the biweekly time and attendance reports showed that the former chairperson was in work status. However, other documentation indicated that the former chairperson was not in work status. For example, during a one-week period, the work itinerary noted that the former chairperson was out of the office and not at work, and he did not claim his usual daily reimbursement for meal and vehicle expenses. This information would indicate that the former chairperson was not in work status. However, the former chairperson's biweekly time and attendance report did not disclose any use of annual leave. In none of these 27 instances did the former chairperson use annual or sick leave to cover apparent absences.

   Personnel-Payroll Information System for Michigan (PPRISM) Procedures Manual section 7.2 requires that employees accurately account for any leave usage on their biweekly time and attendance reports.

b. The former chairperson inappropriately used an assigned State vehicle for personal use unrelated to MLCC business.

   The former chairperson used a State vehicle from November 1995 through September 1997 to make an estimated 400 daily trips to a local radio station to perform functions not related to MLCC. A CIS internal audit determined that the amount of reimbursement required was $1,937 for this personal use of a State vehicle. Section 18.1215(e) of the *Michigan Compiled Laws* prohibits the personal use of State vehicles.

c. The former chairperson was reimbursed for the use of a personal vehicle or reported mileage for the use of a State vehicle to travel approximately 100 miles to or from his home in 54 instances. However, travel times recorded on travel vouchers and the location and time of long distance telephone calls appearing on telephone billings do not support that such travel occurred. The former chairperson informed us that these discrepancies occurred because the travel vouchers did not accurately reflect the arrival and departure times. The questionable travel resulted in approximately $1,400 for mileage expenses.

d. The former chairperson received compensation and/or travel reimbursement for out-of-State travel in 10 instances for which no documentation was available to verify the purpose of the travel.

The former chairperson informed us that he maintained a practice of visiting out-of-State liquor merchants to review liquor prices and to review other states' liquor distribution programs. However, documentation or other corroborative evidence was not available to support these claims. Also, CIS's annual report listing each person who received compensation for out-of-State business travel, as required by Section 18.1217 of the *Michigan Compiled Laws,* did not include any of these trips by the former chairperson. These instances of out-of-State travel resulted in $669 of travel reimbursement paid to the former chairperson.

e. The former chairperson inappropriately directed State employees to perform services unrelated to MLCC operations.

Two MLCC employees informed us that the former chairperson directed them to deliver personal mail and perform other tasks unrelated to MLCC business. During the period January 2, 1996 through September 30, 1997, MLCC employees made 301 trips primarily to deliver mail to the former chairperson at his non-State job at a local radio station or to the former chairperson's local residence. State funds totaling $2,124 were used to reimburse these employees for mileage costs incurred in performing these services. We estimate that the two employees earned wages of approximately $5,280 from State appropriations to perform these services. Also, one employee completed tasks related to the former chairperson's non-State job at the local radio station and performed functions related to another personal business operation. These tasks included making telephone calls, picking up and delivering mail, and updating personal business information.

State appropriations for MLCC should only be used to compensate State employees for performing services related to MLCC business.

Recommendations

We recommend that MLCC establish control procedures to verify the Commissioners' payroll and travel expenses.

We also recommend that MLCC review the former chairperson's payroll and travel expenses and seek reimbursement for those instances that were not appropriate.

We further recommend that MLCC request the former chairperson to reimburse the State for personal services performed by State employees.

Agency Preliminary Response

MLCC agrees with these recommendations. MLCC informed us that it has complied with the first recommendation by establishing control procedures to verify the Commissioners' payroll and travel expenses. MLCC also informed us that it has worked with CIS on the second and third recommendations and did review the former chairperson's payroll and travel expenses. CIS received reimbursement for instances that were not appropriate.

Independent Auditor's Report on
the Internal Control Structure

July 20, 1998

Ms. Jacquelyn A. Stewart, Chairperson
Michigan Liquor Control Commission
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Stewart and Ms. Wilbur:

We have audited the financial statements of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, as of and for the fiscal year ended September 30, 1997 and have issued our report thereon dated July 20, 1998, which included a qualified opinion on the statement of cash flows.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Michigan Liquor Control Commission and the management of the Department of Consumer and Industry Services are responsible for establishing and maintaining an internal control structure, which operates in conjunction with the Statewide internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements for the fiscal year ended September 30, 1997, we obtained an understanding of the Michigan Liquor Control Commission's internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Michigan Liquor Control Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are more fully described in Findings 1 through 5.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure policies and procedures would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the Michigan Liquor Control Commission's internal control structure and its operation that we consider to be material weaknesses as defined above. The Michigan Liquor Control Commission's internal control structure did not adequately separate the duties related to the administration and distribution of the

State's liquor inventory (Finding 1). Also, the Michigan Liquor Control Commission's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *State of Michigan Comprehensive Annual Financial Report* (Finding 2). As a result of the errors noted, we expressed a qualified opinion on the Michigan Liquor Control Commission's statement of cash flows. These conditions were considered in determining the nature, timing, and extent of the procedures performed in our audit of the financial statements for the fiscal year ended September 30, 1997.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

Independent Auditor's Report on
Compliance With Laws and Regulations

July 20, 1998

Ms. Jacquelyn A. Stewart, Chairperson
Michigan Liquor Control Commission
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Stewart and Ms. Wilbur:

We have audited the financial statements of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, as of and for the fiscal year ended September 30, 1997 and have issued our report thereon dated July 20, 1998, which included a qualified opinion on the statement of cash flows.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the Liquor Purchase Revolving Fund is the responsibility of the Michigan Liquor Control Commission and the Department of Consumer and Industry Services management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Liquor Purchase Revolving Fund's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions contained in statutes, regulations, contracts, or grants that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements. The results of our tests of compliance disclosed the following material instance of noncompliance, the effects of which have not been corrected in the Michigan Liquor Control Commission's financial statements for the fiscal year ended September 30, 1997.

The Michigan Liquor Control Commission's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. As a result, the cash flows from operating activities on the Michigan Liquor Control Commission's statement of cash flows were approximately $10.4 million more than the amount reported in the *SOMCAFR* and the cash flows from noncapital financing activities were approximately $10.1 million less than the amount reported in the *SOMCAFR*.

We considered this material instance of noncompliance in forming our opinion on whether the Michigan Liquor Control Commission's financial statements for the fiscal year ended September 30, 1997 are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does affect our report dated July 20, 1998 on those financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the Michigan Liquor Control Commission complied in all material respects with the provisions referred to in the third paragraph of this report and, with respect to items not tested, nothing came to our attention that caused us to believe that the Michigan Liquor Control Commission had not complied, in all material respects, with those provisions.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

Independent Auditor's Report on
the Financial Statements

July 20, 1998

Ms. Jacquelyn A. Stewart, Chairperson
Michigan Liquor Control Commission
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Stewart and Ms. Wilbur:

We have audited the accompanying balance sheet of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, as of September 30, 1997 and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the fiscal year then ended. These financial statements are the responsibility of the Michigan Liquor Control Commission management and the Department of Consumer and Industry Services management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1b, the accompanying financial statements present only the Liquor Purchase Revolving Fund and are not intended to present fairly the financial position and results of operations of the State of Michigan or its enterprise funds.

As described in Finding 2, the Michigan Liquor Control Commission's statement of cash flows contained reporting errors that caused an overstatement of its cash flows from operating activities of approximately $10.4 million and an understatement of its cash flows from noncapital financing activities of approximately $10.1 million.

In our opinion, except for the misstatement of the statement of cash flows as discussed in the preceding paragraph, the financial statements of the Liquor Purchase Revolving Fund referred to in the first paragraph present fairly, in all material respects, the financial position of the Fund as of September 30, 1997 and the results of its operations and cash flows for the fiscal year then ended on the basis of accounting described in Note 1b.

Our audit was made for the purpose of forming an opinion on the Liquor Purchase Revolving Fund's financial statements. The supplemental information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements referred to in the first paragraph. The supplemental information for the fiscal year ended September 30, 1997 has not been subjected to the auditing procedures applied in our audit of the Liquor Purchase Revolving Fund's financial statements and, accordingly, we express no opinion concerning such information.

In accordance with *Government Auditing Standards*, we have also issued a report dated July 20, 1998 on our consideration of the Michigan Liquor Control Commission's internal control structure and a report dated July 20, 1998 on its compliance with laws and regulations.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Balance Sheet
As of September 30, 1997

ASSETS		
Current Assets:		
Cash	$ 1,175,357	
Equity in State Treasurer's Common Cash	42,939,546	
Accounts receivable	119,541	
Inventory of liquor (Note 3)	12,128,540	
Other assets	117,727	
Total Current Assets		$ 56,480,711
Advances to other funds (Note 4)		1,448,222
Fixed Assets (Note 2):		
Land	$ 98,030	
Buildings	2,415,111	
Equipment	849,584	
Total Fixed Assets	$ 3,362,725	
Less: Accumulated depreciation	2,423,834	
Net Fixed Assets		938,891
Total Assets		$ 58,867,824
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Accounts payable	$ 37,041,378	
Warrants outstanding	5,785,366	
Deferred revenue	16,791	
Compensated absences	1,519,850	
Amounts due to other funds	1,063,310	
Total Current Liabilities		$ 45,426,695
Long-Term Liabilities:		
Compensated absences		265,390
Total Liabilities		$ 45,692,085
Fund Equity:		
Retained earnings		13,175,739
Total Liabilities and Fund Equity		$ 58,867,824

The accompanying notes are an integral part of the financial statements.

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Statement of Revenues, Expenses, and Changes in Retained Earnings
Fiscal Year Ended September 30, 1997

TOTAL GROSS SALES	$ 578,137,159	
Less: discounts allowed	98,283,317	
PROCEEDS - SALE OF LIQUOR		$ 479,853,842
Less: Cost of liquor sold		
Beginning inventory	$ 28,966,370	
Add: Purchases	330,255,390	
Freight - distribution cost paid to suppliers	19,342,077	
Freight - warehouse to stores	614,970	
Less: Ending inventory	(12,128,540)	
Cost of liquor sold		367,050,267
GROSS REVENUE FROM SALE OF LIQUOR		$ 112,803,575
Add: Bailment revenue	$ 975,785	
Rent revenue	800,597	
Miscellaneous revenue	16,508	1,792,890
TOTAL REVENUE		$ 114,596,465
EXPENSES AND TRANSFERS		
MLCC Appropriated Expenses:		
Commission	$ 334,326	
Management support	1,976,400	
Licensing and enforcement	3,241,404	
Merchandising and warehousing	12,712,874	
Total MLCC Appropriated Expenses		$ 18,265,004
Other Agencies' Appropriated Expenses:		
Department of Attorney General	$ 572,188	
Office of the Auditor General	94,000	
DMB - Overhead cost	34,800	
Department of Civil Service - Personnel	277,468	
CIS - Data processing services	3,464,500	
CIS - Rent/store capital leases	1,485,713	
CIS - Executive direction	796,547	
CIS - Administrative offices	2,647,671	
Total Other Agencies' Appropriated Expenses Excluding Transfers Not Related to MLCC		9,372,887
Unappropriated Expenses:		
Depreciation of fixed assets	$ 320,047	
Gain (loss) on disposal of fixed assets	(198,723)	
Compensated absences	(2,395,405)	
Total Unappropriated Expenses		(2,274,081)
TOTAL EXPENSES AND TRANSFERS		$ 25,363,810
NET INCOME (not including taxes and grants)		$ 89,232,655
Add: Specific tax, liquor 1.85%		8,256,432
NET REVENUE (before unrelated expenses)		$ 97,489,087
CIS - Transfers for grants not related to MLCC		6,363,058
NET INCOME (not including taxes and grants)		$ 91,126,029
Transfers to General Fund - Cash		91,126,029
Changes in Retained Earnings		$ 0
Retained Earnings - Beginning		13,175,739
RETAINED EARNINGS - ENDING		$ 13,175,739

The accompanying notes are an integral part of the financial statements.

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Statement of Cash Flows
Fiscal Year Ended September 30, 1997

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income (loss)	$ 91,126,029
Adjustments to reconcile net income with net cash provided by (used in) operating activities:	
Depreciation	320,047
Specific tax on liquor	(8,256,432)
Operating transfers in from other funds	17,482,439
Loss on disposal of assets	15,825
Interest expense	9,197
Changes in assets and liabilities:	
Inventories	16,837,830
Other assets	152,044
Accounts payable and other liabilities	296,544
Amounts due to other funds	1,060,870
Deferred revenue	16,791
Net cash provided (used) by operating activities	$ 119,061,184
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Loans made or repayments to other funds	$ 13,441
Specific tax on liquor	8,256,432
Operating transfers out to other funds	(108,617,665)
Net cash provided (used) by noncapital financing activities	$ (100,347,792)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from sale of capital assets	$ 2,249,652
Net cash provided (used) for capital and related financing activities	$ 2,249,652
CASH FLOWS FROM INVESTING ACTIVITIES	
Net cash provided (used) by investing activities	$ 0
Net cash provided (used) - all activities	$ 20,963,043
Cash and cash equivalents at beginning of year	17,366,494
Net increase in cash and cash equivalents	$ 38,329,537
RECONCILIATION OF CASH AND CASH EQUIVALENTS	
Per Balance Sheet Calculations:	
Cash	$ 1,175,357
Equity in Common Cash	42,939,546
Warrants outstanding	(5,785,366)
Cash and cash equivalents at end of year	$ 38,329,537

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and results of operations of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, for the fiscal year ended September 30, 1997. The Fund is a part of the State of Michigan's reporting entity and is reported as an enterprise fund in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR).*

The footnotes accompanying these financial statements relate directly to the Liquor Purchase Revolving Fund. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies, Budgeting and Budgetary Control, Treasurer's Common Cash, Pension Benefits and Other Postemployment Benefits, and Compensated Absences.

b. Basis of Accounting and Presentation

The financial statements contained in this report are prepared on the accrual basis of accounting. The accrual basis of accounting, which emphasizes the measurement of total financial position and results of operations, is explained in more detail in the *SOMCAFR.*

The statement of revenues, expenses, and changes in retained earnings for the fiscal year ended September 30, 1997, contains a departure from the *SOMCAFR* presentation. The Department of Management and Budget (DMB) approved this more detailed financial presentation. The statement of cash flows presentation for fiscal year ended September 30, 1997 departed from the *SOMCAFR* presentation materially and without DMB approval. Cash flows from operating activities were approximately $10.4 million more than the amount reported in the *SOMCAFR*, and cash flows from noncapital financing activities were approximately $10.1 million less than the amount reported in the *SOMCAFR*.

The accompanying financial statements present only the Liquor Purchase Revolving Fund. Accordingly, they are not intended to present fairly the financial position and results of operations of the State of Michigan or its enterprise funds.

Note 2 Fixed Assets and Depreciation

Fixed assets are valued at cost. Depreciable fixed assets are depreciated over their useful lives under the straight-line method. Useful lives by class are:

Asset Class	Useful Life (years)
Buildings	60
Store and Warehouse Equipment	8
Office Equipment	6
Furniture	10

Note 3 Inventory

Inventory is valued at the latest quoted price. This method equates approximately to cost. This method of inventory valuation is not in accordance with generally accepted accounting principles. However, it did not materially affect reported inventory valuation.

Effective January 23, 1997, the Michigan Liquor Control Commission ceased collection of its per case bailment fee for all liquor received in its warehouses. Liquor suppliers and vendors now store liquor inventory at privately owned authorized distribution agent companies.

Note 4 Advances to Other Funds

The statements disclose an interfund receivable of $1,448,222. This receivable is composed of amounts temporarily loaned to other enterprise funds to cover cash shortages. These loans occurred on September 30, 1997 and were returned on October 1, 1997. These loans can take place because all funds involved are participating members of the State Treasurer's Common Cash pool.

Note 5 Retirement Contributions

Eligible employees of the Liquor Purchase Revolving Fund are members of the State Employees' Retirement System. During the fiscal year, the Fund contributed $1,944,856 to the retirement system on behalf of the employees.

Note 6 Budgeting and Budgetary Control

The Legislature, through the annual appropriations acts, establishes a budget for all Liquor Purchase Revolving Fund expense categories except for liquor purchased for resale, freight for internal liquor movement, and depreciation.

Note 7 Leases

The Liquor Purchase Revolving Fund leased 64 sites from private owners for liquor warehouses and stores. The leases expired on February 28, 1997 for all State liquor stores because of the privatization of the liquor distribution. Leases that constitute rental agreements are classified as "operating" leases and the resulting expenses are recognized as incurred over the lease term. Leases that are, in substance, purchases are classified as "capital" leases and the resulting assets and liabilities are recorded at lease inception.

Rental expense incurred under operating leases totaled $955,421 during fiscal year 1996-97. Payments for capital lease principal and interest totaled $77,797 and $9,197, respectively, during fiscal year 1996-97.

Note 8 Rental Income

The Michigan Liquor Control Commission received $800,597 for the lease of its Lincoln Park facility from January 23, 1997 through September 30, 1997.

SUPPLEMENTAL INFORMATION

MICHIGAN LIQUOR CONTROL COMMISSION
Department of Consumer and Industry Services
Schedule of Governmental Funds Revenue and Operating Transfers
Fiscal Year Ended September 30, 1997

RAL FUND		
eneral Purpose Revenue:		
Beer excise tax	$ 41,307,414	
Wine excise tax	6,999,588	
Mixed spirit excise tax	598,056	
Liquor specific tax	22,429,536	
Penalties imposed by the Commission	1,255,169	
Miscellaneous	101,503	
Total General Purpose Revenue		$ 72,691,266
estricted Revenue:		
Liquor specific tax for tourism and convention facility promotion	$ 22,497,568	
Liquor retail license fees	9,558,621	
Sunday sales license fees	1,208,179	
Liquor license transfer fees	633,993	
License fees for Grape and Wine Industry Council	405,520	
Inspection fees	284,478	
Liquor Control Act	7,150	
Miscellaneous	42,936	
Total Restricted Revenue		34,638,445
Total General Fund Revenue		$ 107,329,711
perating Transfers:		
Department of Civil Service Assessment	$ 277,468	
Department of Attorney General Assessment	572,188	
Department of Management and Budget Assessment	34,800	
Office of the Auditor General Assessment	94,000	
Department of Consumer and Industry Services	14,757,489	
Net Income to General Fund	91,126,029	
Total Operating Transfers		106,861,974
Total General Fund Revenue and Operating Transfers		$ 214,191,685
OL AID FUND		
quor specific tax	$ 22,428,338	
ales tax on liquor	6,810	
Total School Aid Fund Revenue		22,435,148
Total Governmental Fund Revenue and Operating Transfers		$ 236,626,833

Glossary of Acronyms and Terms

ADA	authorized distribution agent.
CIS	Department of Consumer and Industry Services.
DMB	Department of Management and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements/schedules of an audited entity are fairly presented in conformity with generally accepted accounting principles.
internal control structure	The management control environment, accounting system, and control policies and procedures established by management to provide reasonable assurance that resources are safeguarded; that resources are used in compliance with laws and regulations; and that financial transactions are properly accounted for and reported.
material weakness	A serious reportable condition in which the design or operation of one or more of the internal control structure elements (including management controls) does not reduce to a relatively low level, the risk that errors or irregularities, in amounts that would be material in relation to the financial statements/schedules, would not be prevented or detected.
MLCC	Michigan Liquor Control Commission.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure.
SOMCAFR	*State of Michigan Comprehensive Annual Financial Report.*